

Message Text

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C O N F I D E N T I A L SECTION 01 OF 03 PARIS 01956

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SUBJ: ELECTIONS 1978 -- CONSTRAINTS ON FRENCH
ECONOMIC POLICIES

REF: PARIS 01250

1. INTRODUCTION AND SUMMARY: WHILE THE MARCH
ELECTIONS CAN MAKE A BIG DIFFERENCE ON THE ECONOMIC
FRONT, ANY NEW GOVERNMENT WILL RAPIDLY COME UP
AGAINST BASIC INTERNAL AND EXTERNAL ECONOMIC
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CONSTRAINTS. TO MAKE MATTERS WORSE, THE NEXT
GOVERNMENT -- WHETHER LEFT, RIGHT OR CENTER -- WILL
PROBABLY BE WEAKER THAN ANY SINCE THE FOURTH
REPUBLIC. ITS PRINCIPAL OBJECTIVE IS LIKELY TO BE
IMPROVED GROWTH TENDING TOWARD FIVE PERCENT A YEAR.
DESPITE THE BARRE PLAN'S PARTIAL SUCCESS, THE NEXT
GOVERNMENT WILL INHERIT A STAGNANT ECONOMY, AN

INFLATION RATE ABOVE NINE PERCENT, AND A MILLION UNEMPLOYED. STIMULATION OF THE ECONOMY WILL RUN UP AGAINST THE RISK OF INFLATION AND BALANCE OF PAYMENTS PRESSURES. SOCIAL DEMANDS -- INCLUDING PRESSURES FOR INCOME REDISTRIBUTION -- WILL COMPLICATE MANAGEMENT OF THE ECONOMY AT A TIME WHEN IMPROVED PROFITABILITY AND INDUSTRIAL RESTRUCTURING ARE NEEDED. FRANCE'S BEST HOPE OVER THE MEDIUM TERM LIES IN EFFORTS TO EXPAND EXPORTS BEYOND WHAT MIGHT RESULT FROM GENERAL IMPROVEMENT OF INTERNATIONAL DEMAND. INFORMED FRENCH OPINION APPRECIATES THE FACTS OF ECONOMIC INTERDEPENDENCE, INCLUDING THE ENERGY EQUATION AND THE DANGERS OF PROTECTIONISM. YET IMMEDIATE POLITICAL AND SOCIAL PRESSURES WILL BE DIFFICULT TO HANDLE WITHOUT EXACERBATING THE EXTERNAL ACCOUNTS. THUS, WHILE THE QUESTION OF WHO GOVERNS FRANCE IS OF GREAT IMPORTANCE, FRENCH ECONOMIC POLICY THE NEXT FEW YEARS IS BOUND TO INCLUDE A HEALTHY ELEMENT OF AD HOC RESPONSE TO SHORT-TERM DEVELOPMENTS.

END INTRODUCTION AND SUMMARY.

2. THE SETTING -- FRANCE IN THE EUROPEAN AND WORLD ECONOMY. FRANCE HAS SUFFERED FROM A CASE OF STAGFLATION SIMILAR TO THAT OF MANY OTHER COUNTRIES THE LAST FEW YEARS. CONSUMPTION AND INVESTMENT ARE SIGNIFICANTLY BELOW LONG-TERM TRENDS: INFLATION IS

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ABOVE THE LONG-TERM TREND. AFTER DECLINING BY ONE PERCENT IN 1975, REAL GROSS DOMESTIC PRODUCT (GDP) INCREASED AT AN AVERAGE OF THREE PERCENT IN 1976 AND 1977. THE INFLATION RATE IN 1977 WAS OVER NINE PERCENT. UNEMPLOYMENT, WHILE DOWN SOMEWHAT RECENTLY, IS STILL OVER ONE MILLION. FRANCE'S EXTERNAL TRADE AND PAYMENTS ARE IN DEFICIT. THE PRESENT GOVERNMENT HAS FINANCED ITS CURRENT ACCOUNT DEFICIT WITHOUT GREAT DIFFICULTY, PRIMARILY BY SHORT-TERM CAPITAL MOVEMENTS INCLUDING SUBSTANTIAL BORROWING ABROAD BY ENTERPRISES. BUT THE EXTERNAL ACCOUNTS REMAIN FRAGILE AND COULD WORSEN RAPIDLY.

3. LIKE MOST INDUSTRIALIZED COUNTRIES, FRANCE STILL FACES A LONG PERIOD OF ADJUSTMENT TO STRUCTURAL CHANGES IN COSTS AND PRICES -- ESPECIALLY FOR ENERGY -- WHICH HAVE YET TO WORK THEIR WAY FULLY THROUGH THE WORLD ECONOMY. JUST AS FRANCE HAD ENJOYED UNPRECEDENTED GROWTH AND PROSPERITY ASSOCIATED WITH GREATER INTEGRATION WITHIN THE WORLD ECONOMY (ESPECIALLY VIA THE EUROPEAN COMMUNITY), SO THE FACT OF INTERDEPENDENCE NOW MAGNIFIES ITS PROBLEMS AND PLACES CONSTRAINTS ON

ITS FUTURE POLICY CHOICES.

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4. THE OIL SQUEEZE. FRENCH INDUSTRY DEPENDS HEAVILY ON IMPORTS OF RAW MATERIALS AND ENERGY. DESPITE ITS RELATIVELY SUCCESSFUL EFFORT AT LIMITING PETROLEUM IMPORTS FRANCE REMAINS VULNERABLE TO ANY FURTHER PRICE INCREASES. RENEWED GROWTH WOULD ALSO IMMEDIATELY INCREASE THE OIL IMPORT BILL. THE TRADE DEFICIT IN ENERGY FOR THE FIRST NINE MONTHS OF 1977 WAS ABOUT 10 BILLION DOLLARS -- OVER 20 PERCENT OF TOTAL IMPORTS. FRANCE PAID THE BILL PARTLY BY SHORT-TERM BORROWING ABROAD AND PARTLY THROUGH A SURPLUS IN EXPORTS OF CAPITAL GOODS AND AUTOMOTIVE EQUIPMENT.

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5. HISTORICALLY FRANCE HAD A MODERATE CURRENT ACCOUNT DEFICIT OFFSET BY LONG-TERM CAPITAL INFLOWS. IF FUNDAMENTAL DISEQUILIBRIUM DEVELOPED THE FRANC WAS DEVALUED. THIS PATTERN IS NO LONGER SUSTAINABLE FOR VARIOUS REASONS. FRANCE HAS NO REAL ALTERNATIVE TO RUNNING A SURPLUS ON OTHER ITEMS SUFFICIENT TO COVER ITS OIL IMPORT BILL WHILE LIMITING BALANCE OF PAYMENTS FINANCING TO NORMAL CYCLICAL FLUCTUATIONS. INCIDENTALLY, THIS CIRCUMSTANCE HELPS EXPLAIN WHY DOMINANT THINKING IN FRANCE OPPOSES TOO SHARP A DECLINE IN THE VALUE OF THE FRANC AND FEARS INTERNATIONAL MONETARY DISORDER. WHILE ACCEPTING THE INEVITABILITY OF FLOATING EXCHANGE RATES, DISORDERLY CONDITIONS UPSET FRENCH PLANNING AND ALSO THREATEN LARGE INCREASES IN IMPORT COSTS AGAINST VERY UNCERTAIN GAINS IN TERMS OF INCREASED EXPORTS.

6. THE GROWTH PROBLEM -- WHAT TO DO? ANY NEW FRENCH GOVERNMENT WILL WANT TO STIMULATE GROWTH BY AT LEAST A MODERATE AMOUNT. THE LEFT WOULD EMPHASIZE INCREASED CONSUMER DEMAND CUM INCOME REDISTRIBUTION. THE MAJORITY IS LIKELY TO EMPHASIZE STIMULATION OF INVESTMENT VIA IMPROVED BUSINESS PROFITABILITY -- RECALLING THAT IN THE POSTWAR PERIOD FRANCE HAS DONE BEST WHEN IT HAS DEVOTED A SUBSTANTIAL PROPORTION OF ITS GDP TO PRODUCTIVE INVESTMENT (AMONG THE HIGHEST IN THE WORLD IN THE LATE 1960'S). BUT THE MAJORITY, TOO, FAVERS INCREASED REAL INCOME FOR WORKERS. TRADE UNION AND OTHER SOCIAL PRESSURES, NOW QUIESCENT, ARE LIKELY TO BECOME ACUTE AFTER THE ELECTIONS. FRENCH BUSINESS IS CHAFING UNDER PRICE CONTROLS AND OTHER GOVERNMENT "INTERFERENCE."

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7. EXPORT EXPANSION COUPLED WITH SOME MEASURE OF SUBSTITUTION IS LIKELY TO FIGURE IMPORTANTLY IN ANY FRENCH GROWTH POLICY EVEN IF INTERNAL DEMAND IS STIMULATED SIMULTANEOUSLY. THE CHANCES FOR RAPID INCREASES IN EXPORTS DEPEND ALMOST ENTIRELY, HOWEVER, ON RESUMED GROWTH IN FRANCE'S MAJOR FOREIGN MARKETS. THE OUTLOOK IN THE EUROPEAN COMMUNITY, WHICH TAKES MORE THAN HALF OF FRENCH TOTAL EXPORTS, IS OF COURSE NOT VERY GOOD. EVEN OVER THE MEDIUM TERM, CHANCES FOR CAPTURING A LARGER SHARE OF THE COMMUNITY MARKET ARE LIMITED, ALTHOUGH THERE SHOULD BE ROOM FOR SOME

EXPANSION IN HIGH-TECHNOLOGY GOODS. AGRICULTURAL SALES WITHIN THE COMMUNITY RUN UP AGAINST A TREND TOWARD GREATER SELF-SUFFICIENCY, ESPECIALLY IN GERMANY, ENCOURAGED BY COMMON AGRICULTURAL POLICY PRICE SUPPORTS. THUS, ON OBJECTIVE GROUNDS, ANY FRENCH GOVERNMENT SHOULD SEEK TO BROADEN ITS TRADING BASE BY DEVELOPING MARKETS IN OPEC AND OTHER DEVELOPING COUNTRIES, IN JAPAN, AND IN NORTH AMERICA. BUT THAT REQUIRES TIME, HARD WORK, AND PROPER RESOURCE ALLOCATION.

8. ON THE IMPORT SIDE, A NEW GOVERNMENT MAY RAPIDLY COME UNDER PRESSURE TO TAKE SELECTIVE OR GENERALIZED MEASURES OF PROTECTION BECAUSE OF BALANCE OF PAYMENTS DETERIORATION. THERE ARE, HOWEVER, REAL LIMITS ON THE POSSIBILITIES FOR IMPORT SUBSTITUTION DUE TO ESSENTIAL NEEDS. THERE IS ALSO THE DANGER OF RETALIATION.

9. TRADE POLICY -- NOT MUCH SCOPE. FRENCH LEADERS HAVE SPOKEN OUT REPEATEDLY ABOUT THE DANGERS OF GENERALIZED PROTECTIONISM GIVEN FRANCE'S POSITION AS A MAJOR EXPORTER (OVER 20 PERCENT OF ITS PRODUCTION). EVEN THE LEFT PROFESSES TO BE AGAINST PROTECTIONISM AS A LONG-TERM POLICY. THE PRESENT GOVERNMENT HAS

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ADVANCED THE CONCEPT OF "ORGANIZED FREE TRADE" WHICH ADDS UP TO (A) SELECTIVE PROTECTION FOR INDUSTRIES

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IN TROUBLE SUCH AS STEEL AND TEXTILES, AND (B) LIMITED .
MOVES TOWARD FURTHER TRADE LIBERALIZATION ON A
MULTILATERAL BASIS VIA THE TOKYO ROUND. WHILE
MAINTAINING THE GOAL OF FREER TRADE, THE MAIN FRENCH
OBJECTIVE IN THE MTN APPEARS TO BE IMPROVED SAFEGUARD
ARRANGEMENTS RATHER THAN IMPROVED MARKET ACCESS.
ALTHOUGH STYLE AND PARTICULARS MAY CHANGE, THIS
GENERAL APPROACH IS LIKELY TO PERSIST AFTER THE
ELECTIONS. (NATURALLY, SHOULD THERE BE A DRAMATIC
AND RAPID WORSENING OF FRANCE'S ECONOMIC POSITION,
ALL BETS MIGHT BE OFF.)

10. LOOKING AHEAD -- REDIRECTING RESOURCES. WHILE
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COPING WITH IMMEDIATE DIFFICULTIES, A RATIONAL
GOVERNMENT WILL WANT TO MAKE A BEGINNING AT IMPROVING
FRANCE'S COMPETITIVE POSITION BOTH WITHIN AND BEYOND
THE EUROPEAN COMMUNITY. TO DO THIS, FRANCE MUST
RATIONALIZE HER INDUSTRIAL STRUCTURE AND KEEP WAGE
AND PRICE INCREASES IN LINE WITH THOSE OF ITS MAJOR
TRADING PARTNERS. IT MUST IMPROVE BUSINESS
PROFITABILITY AND FOSTER PRODUCTIVITY. ATTEMPTS TO
DIVERT RESOURCES FROM DECLINING INDUSTRIES TO HIGH-
TECHNOLOGY SECTORS HAVE BEEN HELD BACK BY THE NEED
TO AVOID AGGRAVATING THE UNEMPLOYMENT SITUATION.
BUT FURTHER WRINGING OUT IN SECTORS SUCH AS TEXTILES,
STEEL, AND SHIPBUILDING SEEMS INEVITABLE. THE
COUNTRY'S BEST HOPE IS TO ASSURE THAT FRANCE IS
COMPETITIVE ON A WORLDWIDE BASIS IN HIGH-TECHNOLOGY;
E.G., THE AEROSPACE INDUSTRY AND TELECOMMUNICATIONS,
WHERE VALUE ADDED IS THE HIGHEST AND THIRD WORLD
COMPETITION IS THE WEAKEST. MORE THAN EVER, THE FRENCH

SEEM TO REALIZE THAT THEIR BEST HOPE FOR THE LONG HAUL IS TO UPGRADE INDUSTRIAL OUTPUT -- BOTH TO EARN FOREIGN EXCHANGE VIA EXPORTS AND TO SAVE FOREIGN EXCHANGE BY SATISFYING DOMESTIC DEMAND WITH HIGH-QUALITY, COMPETITIVE MODELS "MADE IN FRANCE."

11. AFTER THE COSTLY 1976 DROUGHT, FRANCE WANTS TO REESTABLISH ITSELF AS A NET AGRICULTURAL EXPORTER, BUT THERE ARE IMPORTANT PROBLEMS AND RESOURCE CONSTRAINTS IN THIS AREA AS WELL. AS ALREADY INDICATED, OTHER EC COUNTRIES ARE BECOMING MORE SELF-SUFFICIENT. THE MEDITERRANEAN APPLICANTS POSE A THREAT. ANY POLICY OF IMPORT SUBSTITUTION HAS TO BE HIGHLY SELECTIVE SINCE NEW AGRICULTURAL INVESTMENTS ENCOUNTER THE SAME HIGH COSTS OF INPUTS WHICH REDUCE COMPETITIVENESS

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OF FRENCH AGRICULTURAL EXPORTS. (WE HEAR FREQUENT REFERENCES TO NEED TO REDUCE DEPENDENCE ON PROTEIN IMPORTS. WHILE FRANCE'S REAL ECONOMIC INTERESTS SHOULD MILITATE AGAINST LARGE INVESTMENTS IN SOYBEAN SUBSTITUTES, THE POLITICAL PRESSURES ARE ADMITTEDLY STRONG.) IN THE CASE OF BOTH INDUSTRY AND AGRICULTURE, INGRAINED PRACTICES OF THE GOVERNMENTAL BUREAUCRACIES, LABOR, AND THE BUSINESSES THEMSELVES CONSTITUTE A DRAG ON RAPID READAPTATION.

12. WHERE WE COME OUT. THE NEXT FRENCH GOVERNMENT WILL HAVE ITS HANDS FULL TRYING TO SQUARE THE SHORT-TERM ECONOMIC CIRCLE, MUCH LESS OVERHAUL THE FRENCH ECONOMY FOR THE LONGER RUN. POLITICALLY, IT MAY WELL HAVE LESS ROOM FOR MANEUVER THAN BARRE HAS HAD. IT WILL WANT TO STIMULATE GROWTH AND KEEP THE BALANCE OF PAYMENTS AND INFLATION UNDER CONTROL. YET, POSSIBILITIES FOR EXPANDING EXPORTS WILL BE LIMITED AND RESTRAINING IMPORTS WILL BE RISKY. FINANCING AN INCREASED BALANCE OF PAYMENTS DEFICIT MAY PROVE INCREASINGLY DIFFICULT. THUS FRANCE, LIKE MOST OF ITS NEIGHBORS, MUST PRAY FOR RESUMED GROWTH AND STABILITY THROUGHOUT THE WORLD ECONOMY. THE OUTLOOK IS NOT GOOD.

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